BRIEF IN SUPPORT OF PETITION FOR CERTIORARI.

I.

Opinions of the Courts Below.

The opinion of the Circuit Court of Appeals for the Second Circuit was rendered on July 7, 1943. It is reported in 136 Fed. (2d) 978, and is to be found on pages 126 to 130 of the record herein.

The opinion of the Tax Court of the United States is reported in 46 B. T. A. 978 (No. 130), and appears on pages 30 to 41 of the record herein.

II.

Jurisdiction.

The grounds upon which the jurisdiction of this Court is invoked are set forth in subdivision marked "B" of the petition submitted together with this brief.

III.

Statement of the Case.

A full statement of the case has been given under heading "C" in the petition, and in the interest of brevity is not repeated.

IV.

Specification of Errors.

The Circuit Court of Appeals for the Second Circuit erred in the following respects:

1. In holding that petitioner, a transferee in a tax-free reorganization, is not entitled to depreciate the improvements made by its predecessor.

2. In failing to reverse the deficiency order of the Tax Court of the United States.

V.

THE ARGUMENT.

Summary.

Petitioner acquired all its assets from its predecessor in a tax-free reorganization. The building improvements involved in this controversy were a part of the assets so acquired. As a part of the transaction, the petitioner was let into possession of the premises under an existing lease and continued the occupancy of its predecessor, upon its agreement to pay the rental and all other charges reserved therein so long as it continued in possession. Since the date of the reorganization, it has remained in possession of the premises without interruption, using the building improvements in question in its trade or business, and has fulfilled the covenants of its predecessor's lease as well as the lease it subsequently entered into. Under the circumstances, it is entitled to exhaust the cost of those improvements as well as the improvements subsequently installed by it over their useful life by annual charges for depreciation.

Point I.

The Petitioner as Transferee in a Tax-Free Reorganization Is Entitled to Depreciate Improvements Installed by Its Predecessor.

The Circuit Court's decision has completely overlooked certain statutory rights which petitioner acquired by virtue of its status as transferee in a tax-free reorganization. This is apparent from the Court's statement that the petitioner "invested nothing in the improvements."

To entitle a taxpayer to depreciate permanent building improvements, he need not have installed them himself. He

may have received the improved leased property by way of gift, or gift in trust, or through inheritance. In such case, their adjusted basis in his hands, as defined by statute (I. R. C. Sec. 114) is deemed his capital investment, which he is allowed to recoup by annual deductions for depreciation. Or the improvements or the right to use them may have been acquired from a previous tenant, in which case the purchase price or other consideration paid for that right is the investment which may be recovered by depreciation deductions (*Virginian Hotels Corp.* v. *Helvering,* 319 U. S. —; *Cogar* v. *Commissioner,* 44 Fed. (2d) 554, rehear. den. 51 Fed. (2d) 501; *Commissioner* v. *Neighbors Realty Co.,* 81 Fed. (2d) 173; *Midtown Tower Inc.,* 40 B. T. A. 116).

Or, again, as in the case at bar, the taxpayer may have acquired the right to use the property in a tax-free reorganization, in which event it is entitled to use its predecessor's basis for depreciation (*Claridge Apts.,* 1 TC No. 21; *Schweitzer* v. *Conrad, Inc.,* 41 B. T. A. 533; Sec. 113, 114 I. R. C.); this is because in such a reorganization there is "a continuity of the business enterprise under the modified corporate form, and a continuity of interest therein on the part of those persons who were the owners of the enterprise prior to the reorganization" (Code of Federal Regulations, Title 26 I. R., Reg. 103, Sec. 112 (g)-1).

It having been stipulated that the transfer by which the petitioner acquired the right to use the improvements was part of a tax-free reorganization, its right to depreciate the improvements installed by its predecessor follows as a matter of course. Because of the identity of interest of transferor and transferee which characterizes a statutory reorganization, the transferor's investment is made the investment of the transferee, and the former's statutory right to recoup its investment by annual charges to depreciation

becomes the transferee's right. In this manner the legislative purpose of the depreciation allowance, namely, the recovery of an investment in a wasting asset, is fulfilled (Sections 113, 114 I. R. C.).

The Courts below allowed themselves to be diverted from the real points in the case by a consideration of details which had no important bearing upon the basic fact that petitioner acquired the right, title and interest of its predecessor in and to the building improvements and continued, and still continues, to use them in its trade and business.

The Circuit Court dealt tentatively with the question whether the execution by the predecessor and its landlord of a new lease shortening the term and reducing the rental had any effect upon its right to continue to take depreciation, and relegated that question to the background on the theory that it might be "unduly technical".

However, the Court followed its admittedly technical reasoning with the equally technical argument that the exclusion of the lease in the reorganization and the execution of a new lease at a subsequent date did affect the petitioner's right to depreciate the improvements, notwithstanding that there was no interruption in the occupancy of the demised premises nor of possession and use of the building improvements. The Court completely misconceived, on the one hand, the effect of the exclusion of the lease, *which was merely to avoid the assumption by petitioner of a contractual obligation while leaving it liable on the covenants of the lease so long as it remained in possession;* and, on the other, the effect of the execution by petitioner of a new lease in 1937, which merely continued the tenancy and the use of the improvements and consequently perpetuated the right to depreciate instead of extinguishing it. (*The Cleveland Ry. Co.*, 36 B. T. A.

208; *Harris-Emery Co.*, 37 B. T. A. 958; *B. Kirk Rankin*, 60 Fed. (2d) 76).

The existence of a lease of premises on which improvements have been installed has nothing whatever to do with the *right* to depreciate such improvements. The term of a lease is merely a convenient mathematical aid in fixing the time within which the statutory right to depreciation will be exercised and in computing the *rate* at which the depreciation will be taken.

Although in those cases where the courts have had occasion to pass upon a taxpayer's right to depreciate permanent improvements, the taxpayer's occupancy usually has been under a lease, nevertheless, in all the cases, the *sine qua non* of the right to depreciation has been held to be the making of the investment and the use of the property in trade and business, not the ownership of the property or the existence of a lease. (*Helvering* v. *Lazarus*, 308 U. S. 252; *Weiss* v. *Weiner*, 279 U. S. 333; *Rankin* v. *Commissioner*, 60 Fed. (2d) 76; *Detroit Edison Co.* v. *Commissioner*, 319 U. S. 98), and there have been a number of cases with which the Circuit Court's decision conflicts, where the depreciation allowance was granted despite the absence of a lease (*George H. Bowman* v. *Commissioner*, 32 Fed. (2d) 404, Ct. of Appeals, Dist. of Col., (month to month tenancy); *Simon Bricks Co.*, 14 B. T. A. 878; affirmed 45 Fed. (2d) 57, cert. den. 283 U. S. 834, C. C. A. 9, (tenancy at will); *Elmira Arms*, 7 B. T. A. 703 (no lease at all).

In the *Bowman* case, the Court pointed out that it was sufficient to entitle a taxpayer to depreciation if "it is shown that the tenancy extended for a period substantially beyond the taxpayable year in which the adjustment for the improvements is claimed."

The Circuit Court's holding that "petitioner never succeeded to the term of the old company" is contrary to the law of the State of New York. Assuming, for the sake of argument, that at the time of the transfer petitioner was required to succeed to its predecessor's term before acquiring its predecessor's right to depreciate the improvements, this requirement has been fully met. Under the law of the State of New York, "as long as the leasehold estate was in existence, no person or body corporate could give it authority to enter *except under the lease.*" (*Frank* v. *N. Y. L. E. & W. R. R. Co.*, 122 N. Y. 197). "From the fact of possession and the payment of rent it is to be presumed that the (petitioner) was an assignee of the lessee" (*Gillette Bros.* v. *Aristocrat Restaurant*, 239 N. Y. 87), and, paraphrasing the language of *Mann* v. *Munch Brewery*, 225 N. Y. 189, "Payment of rent by the petitioner to the landlord when petitioner has been let into possession by the original lessee, is *prima facie* evidence of the assignment of the whole term."

Point II.

The Cases Cited by the Circuit Court Do Not Support Its Decision.

None of the cases referred to by the Court below in its opinion supports the Court's decision. They really have no application to the question involved.

In *Weiss* v. *Weiner*, 279 U. S. 333 (reversing 27 Fed. (2d) 200), the taxpayer was in the business of taking long term leases on building property and subletting. This Court held that, having made no investment in the buildings, he could not claim depreciation thereon. In *Detroit Edison Company* v. *Commissioner*, 319 U. S. 98, it was held that the investment had been made not by the taxpayer, but by its customers.

In *New Colonial* v. *Helvering,* 292 U. S. 435, it was held that a transferee corporation could not deduct from gross income losses sustained by its predecessor prior to the transfer. There is no statutory provision authorizing such a deduction. There is, however, such authorization for the deduction by the transferee of depreciation of property acquired in the transfer (*Virginian Hotels Corp.* v. *Commissioner,* 319 U. S. —; *Cogar* v. *Commissioner,* 44 Fed. (2d) 554; rehearing den. 51 Fed. (2d) 501).

In *Helvering* v. *Lazarus,* 308 U. S. 252, this Court reaffirmed the basic principle of the depreciation allowance by stating that "one who is not the owner of property may, nevertheless, bear the burden of exhaustion of capital investment."

The cases of *Helvering* v. *Bruun,* 309 U. S. 461, and *Lewis* v. *Pope Estate Co.,* 116 Fed. (2d) 328, upon which the Circuit Court seems to have placed considerable reliance, do not touch the question. Both cases merely set at rest the controversy then existing whether income is realized by the owner when permanent improvements are made to leased premises, or when there is a forfeiture of the leasehold estate and the owner acquires complete possession. Both cases held the latter to be the case. Both have since been superseded by Section 115(a) of the Revenue Act of 1942 which *excludes* from gross income the value of improvements made by a lessee on real property of a lessor. Regardless of the present effect of these decisions, however, the fact remains that here, since the date of the installation of the improvements in 1931, there has been neither a surrender of the premises in which the improvements were installed, nor a cessation of their use in trade or business.

Conclusion.

The question presented, involving as it does the proper interpretation of provisions of the Federal taxing statutes

of far reaching importance, calls for the exercise by this Court of its supervisory powers in order that the decision of the Court below, which deprives taxpayers of a right to depreciation granted by the statutes, may not be perpetuated to petitioner's great detriment and to the great detriment of other taxpayers in like situation.

To that end, a writ of certiorari should be granted, and this Court should review the decision of the Circuit Court of Appeals for the Second Circuit and finally reverse it.

Dated: October 14, 1943.

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